

Notes to the unaudited interim financial report

1 Basis of preparation

This interim financial report is unaudited, but has been reviewed by KPMG in accordance with Statement of Auditing Standards 700 “Engagements to review interim financial reports”, issued by the Hong Kong Society of Accountants (“HKSA”). KPMG’s independent review report to the Board of Directors is set out on page 28. In addition, this interim financial report has been reviewed by the Company’s Audit Committee.

This interim financial report has been prepared in accordance with the requirements of the Main Board Listing Rules of The Stock Exchange of Hong Kong Limited, including compliance with Statement of Standard Accounting Practice (“SSAP”) 25 “Interim financial reporting” issued by the HKSA.

The financial information relating to the financial year ended 31 December 2003 included in the interim financial report does not constitute the Company’s statutory accounts for that financial year but is derived from those accounts. Statutory accounts for the year ended 31 December 2003, on which the auditors have expressed an unqualified opinion on those accounts in their report dated 2 March 2004, are available from the Company’s registered office.

The same accounting policies adopted in the 2003 annual accounts have been applied to the interim financial statements.

The notes on the interim financial report include an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the Group since the issuance of the 2003 annual accounts.

2 Profit on property developments

Profit on property developments includes cost of properties sold of HK\$283 million (2003: HK\$43 million).

3 Dividends

<i>in HK\$ million</i>	Half-year ended 30 June 2004	Half-year ended 30 June 2003
Dividend paid		
2003 final dividend of 28 cents (2002: 28 cents) per share approved and paid in 2004	1,481	1,444
Dividend declared		
Interim dividend declared after the balance sheet date of 14 cents (2003: 14 cents) per share	750	734

4 Earnings per share

The calculation of basic earnings per share is based on the profit for the half-year period ended 30 June 2004 attributable to shareholders of HK\$1,175 million (2003: HK\$113 million) and the weighted average number of ordinary shares of 5,293,223,376 in issue during the period (2003: 5,167,723,476).

The calculation of diluted earnings per share is based on the profit for the half-year period ended 30 June 2004 attributable to shareholders of HK\$1,175 million (2003: HK\$113 million) and the weighted average number of ordinary shares of 5,299,525,136 in issue during the period (2003: 5,168,873,569) after adjusting for the number of dilutive potential ordinary shares under the employee share option schemes calculated as follows:

	Half-year ended 30 June 2004	Half-year ended 30 June 2003
Weighted average number of ordinary shares used in calculating basic earnings per share	5,293,223,376	5,167,723,476
Number of ordinary shares deemed to be issued for no consideration	6,301,760	1,150,093
Weighted average number of ordinary shares used for calculating the diluted earnings per share	5,299,525,136	5,168,873,569

5 Income tax

Income tax in the consolidated profit and loss account represents:

<i>in HK\$ million</i>	Half-year ended 30 June 2004 (Unaudited)	Half-year ended 30 June 2003 (Unaudited)
Current tax		
– overseas tax for the period	1	–
Deferred tax		
– origination and reversal of temporary differences	219	75
– effect of increase in tax rate from 16.0% to 17.5 % on deferred tax balances at 1 January	–	300
	219	375
Share of non-controlled subsidiary's taxation	2	–
	222	375

No provision for current Hong Kong Profits Tax has been made in the consolidated profit and loss account in respect of the Company and its subsidiaries, as the Company and its subsidiaries either have substantial accumulated tax losses brought forward which are available for set off against current period's assessable profits or have sustained tax losses for the period ended 30 June 2004. Taxation for overseas subsidiaries is charged at the appropriate current rates of taxation ruling in the relevant countries.

6 Segmental information

The Group's results of major business activities for the half-year ended 30 June 2004, with comparative figures for the half-year ended 30 June 2003, are summarised below:

<i>in HK\$ million</i>	Railway operations	Station commercial and other businesses	Property ownership and management	Total railway operations and related activities	Property developments	Total
Half-year ended 30 June 2004 (Unaudited)						
Revenue	2,871	579	537	3,987	–	3,987
Less: Operating expenses before depreciation	1,374	128	94	1,596	–	1,596
	1,497	451	443	2,391	–	2,391
Profit on property developments	–	–	–	–	1,153	1,153
Operating profit before depreciation	1,497	451	443	2,391	1,153	3,544
Less: Depreciation	1,182	56	2	1,240	–	1,240
	315	395	441	1,151	1,153	2,304
Unallocated corporate expenses						(184)
Interest and finance charges (net)						(743)
Share of profit of non-controlled subsidiary						20
Income tax						(222)
Profit for the period ended 30 June 2004						1,175
Half-year ended 30 June 2003 (Unaudited)						
Revenue	2,567	512	488	3,567	–	3,567
Less: Operating expenses before depreciation	1,371	133	90	1,594	–	1,594
	1,196	379	398	1,973	–	1,973
Profit on property developments	–	–	–	–	678	678
Operating profit before depreciation	1,196	379	398	1,973	678	2,651
Less: Depreciation	1,126	55	1	1,182	–	1,182
	70	324	397	791	678	1,469
Unallocated corporate expenses						(168)
Interest and finance charges (net)						(824)
Share of profit of non-controlled subsidiary						11
Income tax						(375)
Profit for the period ended 30 June 2003						113

No geographical analysis is shown as substantially all the principal activities of the Group are carried out in Hong Kong.

Profit on property developments for the half-years ended 30 June 2003 and 2004 were mainly recognised from the deferred income account.

7 Investments in subsidiaries

The followings are new subsidiary companies established during the half-year ended 30 June 2004:

Name of company	Issued and paid up ordinary / registered share capital	Proportion of ownership interest			Place of incorporation and operation	Principal activities
		Group's effective interest	Held by the Company	Held by subsidiary		
Candiman Limited	US\$1	100%	100%	–	British Virgin Islands	Investment holding
MTR Corporation (Shenzhen) Limited	HK\$100,000,000	100%	–	100%	The People's Republic of China (Incorporated)	Conduct early-stage preparatory work for Shenzhen Metro Line 4 project

The registered share capital of MTR Corporation (Shenzhen) Limited is to be paid up in four quarterly instalments of equal amount starting from 4 March 2004. As of 30 June 2004, HK\$25 million of MTR Corporation (Shenzhen) Limited's registered share capital has been paid up.

8 Debtors, deposits and payments in advance

The Group's credit policy in respect of receivables arising from its principal activities is as follows:

- i Rentals, advertising and telecommunications fees are billed monthly with due dates ranging from 7 to 50 days. Tenants of the Group's investment properties and station kiosks are required to pay three months' rental deposit upon the signing of lease agreements.
- ii Amounts receivable under interest rate and currency swap agreements with financial institutions are due in accordance with the respective terms of the agreements.
- iii Debtors in relation to contracts and capital works entrusted to the Group, subject to any agreed retentions, are due within 21 days upon the certification of work in progress.

The ageing of debtors relating to the above activities is analysed as follows:

<i>in HK\$ million</i>	At 30 June 2004 (Unaudited)	At 31 December 2003 (Audited)
Amount not yet due	451	775
Overdue by 30 days	72	67
Overdue by 60 days	3	16
Overdue by 90 days	6	9
Overdue by more than 90 days	17	10
Total debtors	549	877
Deposits and payments in advance	335	276
	884	1,153

9 Material related party transactions

The Financial Secretary Incorporated, which holds approximately 76% of the Company's issued share capital on trust for the Government of the Hong Kong SAR, is the majority shareholder of the Company. Transactions between the Group and Government departments, agencies or Government controlled entities, other than those transactions arising in the normal dealings between the Government and the Group, are considered to be related party transactions pursuant to SSAP 20 "Related party disclosures" and are identified separately in this interim financial report.

The Group has had the following material transactions with Government and other related parties during the half-year ended 30 June 2004:

<i>in HK\$ million</i>	Balance at 1 January 2004 (Audited)	Increased / (Decreased)	Balance at 30 June 2004 (Unaudited)
Amounts due from related parties in respect of infrastructure entrustment works:			
– the Government	68	(16)	52
– the Housing Authority	11	–	11
– the Kowloon-Canton Railway Corporation	3	(3)	–
Amount due from non-controlled subsidiary	2	(2)	–
	84	(21)	63
Amounts due to related parties in respect of railway project works entrusted to:			
– the Government	113	(113)	–
– the Airport Authority	48	(48)	–
– the Kowloon-Canton Railway Corporation	–	2	2
Amount due to non-controlled subsidiary	–	3	3
	161	(156)	5

During the period, the following dividends were paid to or waived by the Government:

<i>in HK\$ million</i>	Half-year ended 30 June 2004 (Unaudited)	Half-year ended 30 June 2003 (Unaudited)
Cash dividend paid	420	–
Cash dividend waived	37	441
Shares allotted in respect of scrip dividends	673	659
	1,130	1,100

In connection with the construction of the Disneyland Resort Line (previously known as Penny's Bay Rail Link), the Government agreed to provide financial support to the Company in order to bridge the funding gap between the Company's required rate of return of 11.25% per annum and the projected return of the project. Such financial support, which amounted to HK\$798 million at net present value on 1 January 2002, has been settled by the Government through waivers of its entitlement to cash dividends in respect of its shareholding commencing from the financial year ended 31 December 2002 and thereafter. Such financial support has been fulfilled following Government's waiver of HK\$37 million in respect of the final dividend for the financial year ended 31 December 2003 in the current reporting period.

During the half-year ended 30 June 2004, the Group also had the following transactions with its non-controlled subsidiary, Octopus Cards Limited ("OCL"):

<i>in HK\$ million</i>	Half-year ended 30 June 2004 (Unaudited)	Half-year ended 30 June 2003 (Unaudited)
Payment to OCL in respect of central clearing services	25	21
Fees received from OCL in respect of load agency services, card issuance and refund services and management services	9	6

10 Creditors, accrued charges and provisions

Creditors, accrued charges and provisions are mainly related to capital projects which are settled upon certification of work in progress and swap interest payable. The Group has no significant balances of trade creditors resulting from its provision of transportation services.

The analysis of creditors by due dates is as follows:

<i>in HK\$ million</i>	At 30 June 2004 (Unaudited)	At 31 December 2003 (Audited)
Due within 30 days or on demand	545	541
Due after 30 days but within 60 days	464	590
Due after 60 days but within 90 days	53	75
Due after 90 days	1,599	1,767
	2,661	2,973
Rental and other refundable deposits	567	297
Accrued employee benefits	133	150
Total	3,361	3,420

11 Bonds and notes issued and redeemed

Bonds and notes issued by the Group during the half-years ended 30 June 2004 and 2003 comprise:

<i>in HK\$ million</i>	Half-year ended 30 June 2004		Half-year ended 30 June 2003	
	Principal amount	Net consideration received	Principal amount	Net consideration received
	(Unaudited)		(Unaudited)	
Debt issuance programme notes	4,658	4,610	1,600	1,593

The above notes were issued by a subsidiary, MTR Corporation (C.I.) Limited. The notes issued are unconditionally and irrevocably guaranteed by the Company; and are direct, unsecured, unconditional and unsubordinated to other unsecured and unsubordinated obligations of MTR Corporation (C.I.) Limited. The obligations of the Company under the guarantee are direct, unsecured, unconditional, and unsubordinated to other unsecured and unsubordinated obligations of the Company. The net proceeds received from the issues were on lent to the Company for general working capital, refinancing or other corporate purposes.

During the period, the Group redeemed HK\$3,365 million (2003: Nil) unlisted Hong Kong dollar notes upon maturity.

12 Share capital, share premium and capital reserve

<i>in HK\$ million</i>	At 30 June 2004 (Unaudited)	At 31 December 2003 (Audited)
Authorised:		
6,500,000,000 shares of HK\$1.00 each	6,500	6,500
Issued and fully paid:		
5,356,898,735 shares (2003: 5,288,695,393 shares) of HK\$1.00 each	5,357	5,289
Share premium	3,333	2,609
Capital reserve	27,188	27,188
	35,878	35,086

12 Share capital, share premium and capital reserve (continued)

Pursuant to the Articles of Association of the Company, the capital reserve can only be applied in paying up in full unissued shares to be allotted and distributed as fully paid bonus shares to the shareholders of the Company.

Share premium represents the amount by which the issue price of shares exceeds the par value of those shares. The application of the share premium account is governed by section 48B of the Hong Kong Companies Ordinance.

New shares issued and fully paid up during the period comprise:

	Number of shares	Option / scrip price HK\$	Proceeds credited to		Total HK\$ million
			Share capital account HK\$ million	Share premium account HK\$ million	
Employee share options exercised	6,134,000	8.44	6	46	52
Issued as 2003 final scrip dividends	62,069,342	11.93	62	678	740
	68,203,342		68	724	792

During the half-year ended 30 June 2004, no options was vested and a total of 6,134,000 previously vested share options have been exercised. The weighted average closing price in respect of the share options exercised during the period was HK\$12.13 per share. During the period, there were no share options lapsed and as at 30 June 2004, total options to subscribe for 19,095,500 shares and 1,561,200 shares under the Pre-Global Offering Share Option Scheme and the New Joiners Share Option Scheme respectively remained outstanding. Details of the movements in respect of these schemes during the half-year ended 30 June 2004 are set out under the Corporate Governance and Other Information section on page 12.

13 Other reserves

<i>in HK\$ million</i>	Investment property revaluation reserve	Fixed asset revaluation reserve	Retained profits	Total
30 June 2004 (Unaudited)				
Balance as at 1 January 2004	6,682	18	15,506	22,206
Dividend paid	–	–	(1,481)	(1,481)
Profit for the period	–	–	1,175	1,175
Balance as at 30 June 2004	6,682	18	15,200	21,900
31 December 2003 (Audited)				
Balance as at 1 January 2003	6,406	24	13,234	19,664
Dividends paid	–	–	(2,178)	(2,178)
Surplus/(Deficits) on revaluation, net of deferred tax	276	(6)	–	270
Profit for the year	–	–	4,450	4,450
Balance as at 31 December 2003	6,682	18	15,506	22,206

The investment property and fixed asset revaluation reserves are not available for distribution to shareholders because they do not constitute realised profits. As at 30 June 2004, the total amount of reserves available for distribution to shareholders under the Hong Kong Companies Ordinance amounted to HK\$14,959 million (2003: HK\$15,305 million).

14 Capital commitments

i Outstanding capital commitments as at 30 June 2004 not provided for in the accounts were as follows:

<i>in HK\$ million</i>	Railway operations	Disneyland Resort Line and Tung Chung Cable Car Projects	Property development projects	Total
At 30 June 2004 (Unaudited)				
Authorised but not yet contracted for	637	–	1,715	2,352
Authorised and contracted for	1,175	699	123	1,997
	1,812	699	1,838	4,349
At 31 December 2003 (Audited)				
Authorised but not yet contracted for	470	–	1,817	2,287
Authorised and contracted for	892	941	70	1,903
	1,362	941	1,887	4,190

Included in the amounts authorised but not yet contracted for are costs that will not be subject to capital contracts such as staff costs, overhead expenses and capitalised interest.

ii The commitments under railway operations comprise the following:

<i>in HK\$ million</i>	Improvement and enhancement works	Acquisition of property, plant and equipment	Total
At 30 June 2004 (Unaudited)			
Authorised but not yet contracted for	507	130	637
Authorised and contracted for	333	842	1,175
	840	972	1,812
At 31 December 2003 (Audited)			
Authorised but not yet contracted for	348	122	470
Authorised and contracted for	394	498	892
	742	620	1,362

iii Commitments in respect of jointly controlled operations have been included in the commitments for Property Development Projects above and were as follows:

<i>in HK\$ million</i>	At 30 June 2004 (Unaudited)	At 31 December 2003 (Audited)
Authorised but not yet contracted for	1,715	1,931
Authorised and contracted for	115	57
	1,830	1,988

15 Comparative figures

Certain comparative figures have been reclassified to conform with the current year's presentation.

16 Approval of interim financial report

The interim financial report was approved by the Board on 3 August 2004.